

Friday
(Noon)

July 3, 1981

This week, interest rates rose sharply in response to pressure on dealer inventories, slack buying of new issues by retail investors, and a rising Federal funds rate. Also weighing on market sentiment was the view enunciated by Treasury Secretary Regan on Tuesday that the Federal Reserve might not alter its policy stance even after its meeting on July 7.

Ironically, data on bank reserves positions released Thursday night strongly suggest that the Fed already eased its policy stance during the statement week ended last Wednesday, July 1. The most likely precipitating factor was the continuing sluggish money growth--confirmed that week by the new benchmark revisions to the money stock data.

The key evidence is the sharp drop of net borrowed reserves to \$1.25 billion that statement week, well down from the \$1.88 billion average in the prior eight statement weeks. While it is conceivable that such a decline could be the product of a miss in the Fed's projections of operating factors, that seems unlikely, especially since it was the lowest level since mid-April.

If the Fed really is putting less pressure on bank reserves positions, why did the funds rate soar during the last several days? The best guess is that a host of technical problems distorted the funds market. It is well known that many banks engage in "window dressing" to make their balance sheets appear more liquid on their June 30 end of quarter statements of condition. Their increased demand for excess reserves always puts pressure on the funds market and explains why the market was firm on Tuesday. But the pressure on the funds rate began to build on Wednesday. That may have reflected a poor distribution of reserves continuing from Tuesday, amplified by the slightly greater than normal share of Wednesday borrowing from the Fed discount window. Moreover, a number of banks apparently discovered that day that although Wednesday was the first day of the third calendar quarter, the Fed was treating it as part of the second quarter in determining the applicability of the 4% surcharge over the basic 14% discount rate. That would naturally impart more aggressiveness to banks' bidding for funds. Also, in advance of the holiday weekend, banks were probably more aggressive than normal in bidding for funds. After the weekend, however, these pressures should abate; and during the next week or two, the funds rate should trade down under 18%.

If there is any moral whatever to be gleaned from all this, it is that net borrowed reserves is far superior to the funds rate as an indicator of the Fed's policy stance.

William C. Melton

Note: The full text of the letter is available to Telerate subscribers on pages 7250-51 on the Monday morning following the Friday date of the letter.

	7/3/81 (Noon)	Week Ago	Year Ago
Prime Lending Rate at Irving Trust Company	20.00%	20.00%	12.00%
Effective since	6/2/81		
Discount Rate at Federal Reserve Bank	14.00	14.00	11.00
Federal Funds	19.75	18.50	9.38
Repurchase Agreements	19.00	15.00	8.25
U.S. Treasury Issues*			
Bills			
3 months	15.02	14.75	7.96
6 months	15.28	15.10	7.89
1 year	14.91	14.70	7.89
Coupons			
2 years	14.73	14.46	8.21
4 years	14.38	14.10	9.32
7 years	14.07	13.88	9.68
10 years	13.86	13.64	10.10
Long Bond	13.31	13.09	10.00
Negotiable Certificates of Deposit-Secondary Market *			
1 month	17.70	17.45	8.50
3 months	17.30	16.85	8.60
6 months	17.00	16.20	8.60
1 year	16.00	15.75	9.00
Banker's Acceptances*			
1 month	17.75	17.25	8.80
3 months	17.30	16.85	8.75
6 months	17.00	16.40	8.60
Eurodollar Deposits			
1 month	18.63	18.38	9.25
2 months	18.25	18.00	9.31
3 months	18.25	18.00	9.38
Commercial Paper - Prime Names			
Directly placed by:			
Finance Companies			
1 week	18.50	17.00	6.00
1 month	17.00	16.50	8.25
3 months	15.00	15.00	8.00
Bank Holding Companies			
1 month	17.25	16.75	8.50
Dealer Placed:			
3 months	NA	16.50	8.38
New AA Corporate Utility Bond	15.50	15.75	11.75
Tax Exempt			
6 month Project Notes	7.30	7.50	4.35
1 year AAA Bond	7.55	8.00	5.00
5 year AAA Bond	8.70	8.75	5.50
20 year AAA Bond	10.10	10.15	7.10

This information represents prevailing market yields.

It should not be construed as an offering.

All yields are on the offered side of the market.

***Close of Market 7/2/81**

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